

THE
GEORGE WASHINGTON UNIVERSITY
NAVY GRADUATE COMPTROLLERSHIP PROGRAM

THE CAPITALIZATION OF NAVY TECHNICAL STORES
INTO THE NAVAL STOCK ACCOUNT

By

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For

Dr. A. Rex Johnson

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PREFACE

The writer of this paper became aware of the growing importance of Stock Fund Financing while attending Navy Budget Director's hearings in September of 1954. Upon being given the assignment to prepare a term paper for the Comptrollership Course under the Navy Graduate Comptrollership Program at the George Washington University, I determined to write on this subject. Because of a remark by Admiral Clextion to Admiral Hetter about Stock Funding of Aeronautical Materials, I determined to make my subject the Capitalization of Technical Store into the Stock Account.

Upon further investigation I found that this subject was under active consideration by various Bureaus and offices of the Navy Department. While no formalized plan has been evolved, I believe that Stock Funding of Technical Stores will be a reality in less than three years.

I should like to express my deep appreciation to Commander D. H. Lyness and Lieutenant Commander R. M. Slettvet of the Stock Finance Division of the Bureau of Supplies and Accounts and to Commander C. A. Raymond, Jr. of the Navy Comptroller's office for their many helpful comments and suggestions. It was their help and guidance that enabled me to prepare this paper.

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CHAPTER I

THE PRESENT HANDLING AND FINANCING OF NAVY STORES

The Nature of Navy Stores.--Navy Equipment is divided into two broad categories, Capital Equipment and Operating Equipment, Supplies and Spare Parts. This latter category, Operating Equipment, Supplies and Spare Parts, will be referred to in this article as Navy Stores. Navy Stores consist of all those items of Equipment, Supplies and Spare Parts necessary to support modern Naval Operations, to keep the Capital Equipment in first class operating order and to maintain, feed and clothe Naval Personnel.

The Navy Stores Accounts.--Almost fifteen billion dollars¹ worth of material comprise the Navy Stores Accounts. These Stores are broken into two categories for accounting purposes. The two categories form two Stores Accounts, one of which is known as the Naval Stock Account and the other as the Appropriation Purchases Account. The Naval Stock Account is a funded revolving account which is financed by the Naval Stock Fund. Material issued from this account must be charged to an allotment or appropriation upon issue. The Appropriation Purchases Account is material held in store which has been procured and charged against Allotment or Appropriation at the time of procurement and is held in store for use in accordance with the procuring activities instruction. The Naval Stock Account is composed of 1.7 billion dollars¹ worth of material and the Appropriation Purchases Account has 12.6 billion dollars¹ worth of material.

¹Navy Department Office of Comptroller Financial Report Fiscal Year 1954
NavExos Publication P-1170 (Washington Government Printing Office 1954) p. 58

The Stores held in the Naval Stock Account are fast moving, commercial type, or widely used items of material.

The Navy Stock Fund was first originated by Congressional Act of 19 June 1878. The Act of 3 March 1893 gave the Fund official standing by providing the following, "The Secretary of the Treasury is hereby authorized and directed to cause the General Accounts of Advances to be charged \$200,000, which amount shall be carried to the credit of a permanent Navy Stock Fund to be used under the direction of the Secretary of the Navy in the purchase of ordinary commercial supplies for the Naval Services and to be reimbursed from proper Naval appropriation whenever the supplies purchased under said funds are issued." The Budget and Accounting Act of 1921, as passed by Congress, also continued the Fund and stated "The Fund shall be charged with the cost of all stores procured for and credited with the value of all issues or sales made from the Naval Supply Account."² The Title IV Amendment to the National Security Act of 1949 authorized the Secretary of Defense to establish working capital funds for the three military departments.³ The Fund as of 30 June 1954 totaled 2.2 billion dollars⁴ of which 1.7 billion dollars⁴ was invested in the Navy Stock Account. The Appropriation Purchases Account is used to include all that material purchased out of yearly or continuing appropriations and placed in store for future use. This includes a large variety of items and each Bureau retains title to its own material. This creates many problems when transferring material from one account to another to use for some purpose other than that for which originally purchased, even though it may have been lying unused for years. The major

²41 Stat. 1169

³Public Law 216, Sec. 405, 81st Congress

⁴Financial Report Fiscal Year 1954, op. cit., p. 58

items comprising the Appropriation Purchases Account and the money value of each are: Spare parts and minor items of equipment,⁵ 4.5 billion dollars; ordnance and ammunition, 4.9 billion dollars; major BuAer equipment, .1 billion dollars; major BuShips equipment, 1.5 billion dollars; major BuDocks equipment, .2 billion dollars; and Bureau of Supplies and Accounts controlled items of excess material, Government furnished equipment and material handling equipment, 1.2 billion dollars.

When the Navy concept of the Stock Account was first developed in 1878, the nature of Navy Stores was much simpler than today. Most items of Stores and Equipage came under the definition of material to be purchased by the Stock Fund as they could be purchased from any ordinary Ship Chandler. The principal exceptions were ammunition and items of ordnance. As ammunition expenditures were small, ordnance replacement infrequent and modern fire control unknown, these items were not major yearly expenditures. There was little problem in securing individual appropriations for these items the same as for other items of capital equipment. This theory was maintained for all stores other than common items. As ships have grown more and more complicated, these stores have increased in number and kind. The first big addition was the advent of steam, followed by electricity and then other items of machinery. The evolution continued with the invention of the airplane and electronics, just to mention two of the more revolutionary innovations in modern Naval warfare. These steps have caused Navy appropriations to increase from 14.7 million dollars in 1879, of which 3 thousand was carried forward to 1880, to 13.2 billion in 1953, of which 16.8 billion was carried forward to 1954.⁵ These figures give a comparison of

⁵Ibid, p. 58, p. 60

the increase in complexity of financial management and the difficulty of understanding by even the super-intelligent individual.

The Development of the Navy Supply System.--To keep up with these increased appropriations and increased inventory, constant innovations have been necessary. Progress was gradual and orderly until about 1936. At this time the Navy appropriation was about 350 million dollars,⁶ but with the advent of the airplane and electronics, followed by World War II, systems had to be developed to handle the quickly mushrooming business of the Navy. The greatest growing pains were experienced by the Bureau of Aeronautics. The Bureau of Ships was an older and more experienced organization and was able to handle its expansion within the existing organization. Ships were still counted in 100's or 1000's, but aircraft soon started to be counted by the 10's of thousands. Items of aeronautical equipment had to be better controlled for, in addition to the greater number of aircraft, a ship carries most of its equipment and spare parts with it, and aircraft carries none. Aeronautical supply is further complicated by the fact that aircraft moves thousands of miles in a short period of time and must have support wherever they land. A further problem is the rapid obsolescence of aircraft, with a life of 3 to 5 years, compared with a ship's 20 to 30 years. Thus the magnitude and complexity of the aviation supply support can readily be seen. The time quickly passed where the Bureau of Aeronautics could carry out the job alone. Many supply support tasks were passed to the Supply Department of the Naval Aircraft Factory in Philadelphia where, under the able leadership of Commander, later Admiral Dorsey Foster, the Supply Officer, systems for supply support began to develop. The need rapidly outgrew both the physical and management parameters of the parent command, and in 1942 the

⁶Ibid, p. 60

Aviation Supply Office was commissioned. World War II was in the early stages at this time and almost immediately the experienced supply officers were transferred from the organization to other commands. However, Admiral Foster was able to obtain several senior executives from Sears and Roebuck and Macy's to serve as senior officers in his command.

Under Admiral Foster's leadership, and with the able assistance of these experienced stock control personnel from the world of business, the embryo of the supply demand control concept as we know it today was developed as a war baby. The emphasis at this time was on item control and adequate supply logistics--"getting enough where it was needed". The Navy concept during the first year of the war was buy, buy, buy. Because of the war emergency, wherein action of necessity preceded planning, it was assumed that before deliveries could be completed, needs could be surveyed and adjusted.

As the war developed, the need for a look at logistic and operational support was obvious. A study was performed, for the aeronautical part of the Navy, by the Radford Board. The recommendations of the Radford Board affirmed the need for Aviation Supply Office and, in doing so, the supply demand control concept. BuShips in the meantime had found the world wide logistic support of thousands of ships made augmentation of its existing organization necessary and established a Ship's Spare Parts Control Center at Mechanicsburg. Shortly before the war was over, Admiral Fox, who had been Admiral Foster's deputy, was assigned to Mechanicsburg to assume command of Ship's Spare Parts Control Center under the cognizance of the Bureau of Supplies and Accounts. The Control System used for Stock Funded Material and by the other technical Bureaus had weathered the war although the need for new and separate inventory control organizations was realized by all. In 1947 the manager of the Stock Fund

As you can see, the first step is to identify the problem. Once you have identified the problem, you can then move on to the second step, which is to determine the cause of the problem. This is a critical step because it will help you to understand the problem better and to develop a more effective solution. Once you have identified the cause of the problem, you can then move on to the third step, which is to develop a plan of action. This plan should be specific and detailed, and it should include a timeline for completion. Finally, you should implement the plan and monitor its progress to ensure that it is effective.

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reported to his superior, "Proper control and administration of the Naval Stock Fund is impossible under existing conditions."⁷ Also in 1947 the Integrated Supply Plan was developed and published. During that year the General Stores Supply Office was established and the old Stock Division of the Bureau of Supplies and Accounts was disestablished. During that year and the next, other stocks were turned over to newly established Supply Demand Control Points. By the end of 1948 the Integrated Supply System, as it is known today, was almost complete.

This Integrated Supply System is described simply as follows: fourteen Supply Demand Control Points charged with the procurement, control and distribution of General Store, Spare Parts and Small Items of equipage and equipment; the Technical Bureaus charged with the procurement, distribution and control of major items of equipment, ammunition and capital equipment; and the Supply System charged with the storage and issue of practically all the above material except ammunition. For the purposes of this discussion, only the Supply Demand Control Point controlled items will be considered. These are the hard to handle items and are by far the most numerous, item and volume wise. These items consist of about one-third of the Navy's Appropriation Purchases Account inventory. The total inventory is 12 plus billion. The 4.5 billion dollars Supply Demand Control Point controlled inventory contains over 2 million items. The balance of the 8 billion dollars in this Appropriation Purchases Account is made up of 3 billion of ammunition and 5 billion of major items of equipment,⁸ comprising only a few thousand items. It is undoubtedly true that the Supply Demand Control Point concept is applicable for ammunition, but since ammunition is outside the Integrated Supply System, it will not be discussed further.

⁷ Navy Department, Bureau of Supplies and Accounts, Memo DM2 to DM dated 12 August 1947 (typewritten)

⁸ Financial Report Fiscal 1954, Op. Cit., p. 58

Financial Management of Navy Store Accounts.--The Integrated Supply System has well met the need of the operating forces. The Supply Centers and Depots function well, but the responsibility for centralized inventory control, budgeting and financial control of the system functions with varying degrees of success. This discussion is on the budgeting financial control aspect and, therefore, inventory control will be mentioned only insofar as they are inter-related.

For a long time the Navy has had the Naval Stock Fund which has proved an excellent method of financing its non-technical type stores. The present Appropriation Purchases Account System into which Technical Stores purchased out of yearly appropriations and charged to final expenditure were developed with little thought of being used for budgeting or financial controls. Therefore, this is the area in which the greatest improvement is required. The Supply Demand Control Point concept proved its worth in World War II in support of the Cold War and in the Korean Emergency. The financial management authority and budgeting have not kept pace with other developments.

Under the present system, the management of the Supply Demand Control Points have been charged with a responsibility for having material where needed, when needed. However, they have not been given a commensurate control over the budget necessary to carry out their mission. They receive funds and/or material from several sources, such as: a percent of the money allocated for capital item procurement, funds budgeted for by Supply Demand Control Points and included in the Technical Control Bureau's budget as a part of its maintenance and operation budget request, and material in lieu of funds turned over for distribution by Technical Bureaus. These are the three principal sources

of money or material. These methods are functioning but they have the disadvantage of not allowing pinpointing of responsibility or giving financial authority commensurate with responsibility.

Another disadvantage, and by far the most serious in today's complex Navy financial management, is that appropriations and expenditures cannot be related to any time period. Also, annual appropriations cannot be tied to the Chief of Naval Operations program of operations. To overcome these difficulties and to gain other advantages, it is proposed that the Navy Technical Stores, now carried in Appropriation Purchases Account and presently under the control of Supply Demand Control Points, be capitalized into the Navy Stock Account.

CHAPTER II

THE ADVANTAGE OF STOCK FUND FINANCING AND PROBLEM TO BE SOLVED PRIOR TO USING IT FOR NAVY TECHNICAL STORES

Advantages of Stock Fund Financing.--The capitalization of the presently owned Bureau stores into the Naval Stock Accounts would solve the major financial management problems. Before discussing the detailed operational and administrative procedures, it would be well to note some of the advantages of stock fund financing derived by using it for General Stores. Some of the main benefits are found in the December, 1949, Semi-Annual Report of the Navy Stock Fund made to the House and Senate Appropriation Committees on the advantages of fund operation.¹

1. The Navy Stock Fund provides an efficient and businesslike means for procurement and distribution of common-use items to the demands of the Navy. It enables the Navy to take advantage of its buying power through setting up central procurement on a standardized basis making possible long production runs where advantageous, and favorable contacts as to price and terms of delivery.

2. It enables the Navy to make seasonal purchases of items which are produced on a seasonal pattern, such as food. Seasonal buying advantages through off-season purchases also accrue where seasonal fluctuations in general demand occur, as is the case of coal and some petroleum products.

3. The computation of requirements for procurement is greatly simplified because the Navy-wide demand history for each item of supply is accumulated over a long period, and a general averaging of fluctuations of individual consumer's needs in the large population of total Navy demand lends a stabilizing effect.

4. The central control of inventory assets of common-use items by one office in behalf of the Navy makes it possible to set off the total Navy assets against the total demand for each item, in order that procurement

¹Navy Department, Bureau of Supplies and Accounts Monthly Newsletter, May 1952, PP. 11-14

will be placed only for the deficiency. Material which must be rationed because of short supply in the national economy is made available to Naval users in order of priority of the use rather than allowing a relative plenty in some areas at the expense of even a minimum support in others.

5. The over-all policy of inventories for many and varied purposes results in dependence upon a single safety level of supply in each location rather than on multiple stocks. A single system of stock of a given item at a given activity in a single location is achieved.

6. Comparable advantages through maintenance of a single mobilization reserve inventory on a Navy-wide basis are achieved and once mobilization reserve capital has been provided and applied, the protection that this investment represents is not subject to dissipation through unauthorized usage for current operations.

7. The stock fund tends to improve the management of appropriations granted for the various maintenance and operation functions of the Navy which consume common material. The appropriation charges are made promptly for the month in which the material is withdrawn for use, and the cost accounting and appropriation accounting are simultaneously done in a single transaction. In effect the consumers are on a consumption budget which encourages accrual accounting and performance planning of budgets. Accounting mechanics are simplified in that appropriation charges and cost accounts are accumulated through a system of machine summarization which results in monthly transaction clearings and reports to the departmental level.

Another advantage of Stock Fund financing is the psychological effect on personnel of having to pay for materials when it is drawn for use. This payment makes personnel much more cost conscious than when drawing "free issue" Appropriation Purchases Account material. Thus the stock fund tends to improve the management of appropriations granted for the various maintenance and operation functions of the Navy which consume common material. The appropriations charges are made promptly for the month in which the material is withdrawn for use, and the cost accounting and appropriation accounting are simultaneously done in a single transaction. In effect, the consumers are on a consumption budget. Accounting mechanics are simplified, in that appropriation charges and cost accounts are accumulated through a system of machine summarization which results in monthly transactions, clearings and reports to departmental level.

Saving Derived from Stock Fund Operation.--With the expenditures of the Navy running about 10 billion dollars a year, the saving made by use of the Stock Fund is considerable. The following statement on savings was made in the report to the House and Senate Appropriations Committees in December, 1951. "If common use items were paid for at the time of purchase with the money from different appropriations, and distributed with them in mind, requiring the maintaining of financial differentiation all along the line, the work of procurement, distribution, accounting, stock control, warehousing, etc., would be markedly increased."²

Problems to be Solved Prior to Capitalization of Technical Stores into Naval Stock Account.--There are many major problems to be solved if the Stock Fund financing is to be adopted for Technical Stores. These problems may be enumerated as follows:

1. The securing of necessary funds to create sufficient liquidity after the capitalization of the Technical Store into the Navy Stock Account.
2. The protection of the Technical Bureau's responsibility for control over the all important program and broad requirement determination function.
3. The appropriation adjustments necessary to transfer funds from present appropriation to maintenance appropriation in order that the Technical Bureaus may procure material from Stock Account.
4. The loss to the Technical Bureaus of material for which money would have to be reappropriated to buy back from the fund after capitalization.

²Ibid, p. 11

5. A method of control and financing of the repair of used and damaged materials.
6. A method of control and financing of materials for fleet and station allowance.
7. The financing of obsolescent material.
8. The control and financing of materials held for reserve fleets and aircraft.
9. The integration of stock reporting and financial control in order that issues will reflect only final expenditures issues so that fund replacements and procurements will be in balance.
10. The integration of spare part procurement with capital item procurement so that advantage may be taken of capital item production equipment in production of spare parts.
11. Modify the Department of Defense Regulations of 2 February 1954 for Section 405 of National Security Act of 1948 concerning Stock Fund Financing.

The above problems reflect by no means all problems to be solved or decisions to be made, but their satisfactory solution would be such a major step to the accomplishment of successful capitalization of Technical Stores into the Stock Account that the balance would prove inconsequential.

CHAPTER III

THE RELATIONSHIP OF THE TECHNICAL BUREAU TO THE SUPPLY DEMAND CONTROL POINT

The Supply Demand Control Point Technical Bureau Relationship.--The Navy Supply System has now reached such a state of development that it is believed the accomplishment of this handling of technical stores under a stock fund is possible. Under the Navy Supply Plan of 1947, Supply Demand Control Points have been established for the 14 major categories of material. These Supply Demand Control Points serve as agents of the Technical Bureau, with supply management coordination increased by Bureau of Supplies and Accounts. The 14 Supply Demand Control Points are as follows:¹

<u>Symbol</u>	<u>Supply Demand Control Points</u>	<u>Technical Bureau</u>
1. 2	Ordnance Stock Office	BuOrd
2. R	Aviation Supply Office	BuAer
3. H	Ship Spare Parts Control Center	BuShip
4. A	Special Shipboard Elec. Fit. & Fix.	BuShip
5. P	Submarine Supply Office	BuShip
6. W	Electronics Supply Office	BuShip
7. Y	Yard & Docks Supply Office	BuY&D
8. L	Medical & Dental Supply Office	BuMed
9. G	General Stores Supply Office	BuS&A
10. M	Provisions Supply Office	BuS&A

¹Financial Report Fiscal Year 1954, Op. Cit., P. 58

<u>Symbol</u>	<u>Supply Demand Control Points</u>	<u>Technical Bureau</u>
11. W	Fuel Supply Office	BuS&A
12. Q	Navy Ships Store Office	BuS&A
13. U	Clothing Supply Office	BuS&A
14. T	Special Devices Center	ONR

The Supply Demand Control Points are operating agents, translating Technical Bureau Programs into detailed requirements determination, procurement and distribution action. The discharge of the responsibility has required close and continuing communication channels. These channels, wherein the program and broad requirement determination made by the parent Technical Bureau are translated into detailed supply actions by Supply Demand Control Points, are the basic elements in interpretation and support of Bureau responsibility, as they relate to material.

It is vital here to note that a change in the method of financing would in no way change this basic pattern. The examination of several material categories included in the 1.7² billion dollar Stock Account presently existing, i.e.: General Store, Common Electronics, Automotive Repair Parts, Medical and Dental Supplies and Special Shipboard Electrical Fittings and Fixtures, is proof of this statement. Bureaus would be relieved of the budgeting responsibility for stock fund investment without any loss of control over the all important program and broad requirement determination.

²Ibid, p. 69

CHAPTER IV

THE CO-RELATION OF CHIEF OF NAVAL OPERATIONS PROGRAM OBJECTIVES WITH THE MAINTENANCE AND OPERATIONS BUDGET

Relationship Between Chief of Naval Operations Program Objectives and Budgeting.--Before going into a detailed discussion of problem solutions, it would probably be well to study the most serious disadvantage of the present system of financing Technical Stores. There is no relationship between the Chief of Naval Operations program objectives and the part of the annual maintenance and operations appropriation used for procurement of Technical Stores. Stated more simply, there is no relationship between appropriation expenditures and/or obligations and material used.

This serious inconsistency is caused by the fact that money appropriated for Fiscal 1955, for example, is used to buy material for which procurements are made, commencing 1 July 1954 and ending, in most cases, 1 July 1955. The contracts for this material have a procurement leadtime of from 30 days to 3 or 5 years. The 30 day leadtime material expenditures could be coordinated with appropriations, but this type of material is the exception and not the rule. This is further complicated by the fact that 6 or 9 month stock levels are maintained, so it can readily be seen that long leadtime plus stock levels completely becloud any picture of the extent to which current appropriations and current material expenditures are related.

A relationship between the Chief of Naval Operations program planning and material expenditures exists. This relationship could be used to a great advantage if material procurement were financed from a Stock Fund and

appropriations were made to reimburse the fund for material drawn therefrom. To illustrate, it has been found that there is a direct relationship between flight hours and material issues. The correlation between these two has proved 93 percent in test cases run.

The bringing together of the Chief of Naval Operations program objectives and the appropriation is of prime importance to the Secretary of the Navy and the Chief of Naval Operations. The supply programs of the various Bureaus are significant only when related to their contribution to the overall program objective. The present budget process which compartmentalizes annual appropriations allows co-mingling of stock investment and consumption funds. This makes identification of program relationship and appropriate review action exceedingly difficult.

The Advantage to Top Navy Management of Capitalization of Navy Technical Stores into the Navy Stock Account.--With integrated funding, this separating of investment and consumption and the review problem would disappear. This would be invaluable to top Navy Management in reviewing the stock investment plans of the various Bureaus for peacetime programs. It would be even more valuable to Navy Management in evaluation and review of the Navy's position in relation to mobilization material readiness. It is in this area that unbalance between programs is most prevalent, and of most potential consequence.

An accompanying advantage from the standpoint of Top Navy Management would be the common placement of funding and supply management responsibilities and authority whenever a division exists between these two. As is now the case among the Technical Bureaus and between Technical Bureaus and the Operating Supply Demand Control Points, there is opportunity for confusion and passing of responsibility. Either eventuality is untenable to top management which must

have clear delegation lines of both responsibility and authority to prevent error, and require corrective action where errors occur. The capitalization of Technical Stores into the Stock Accounts would allow top management to see that the Chief of Naval Operations program objectives are properly financed and pinpoint responsibility for each phase.

CHAPTER V

SOLUTION TO PROBLEMS THAT ARISE THROUGH CAPITALIZATION

Problems and Solution.--In order to make Stock Fund Financing a success, the problems enumerated earlier must be solved. They are not in most cases too difficult, but merely require different methods in order to fit into the capitalization concept.

Additional Liquidity.--The first problem to be solved is the obtaining of the necessary cash to give the fund the liquidity necessary for operation. This problem has already been solved by Congress under Public Law 216. Public Law 216 allows the transferring of all the unexpended balance held in Navy appropriations.¹ There are at present about 600 million dollars available from this source. These funds have to be transferred, with permission of the President, prior to 31 December 1954. The Navy has initiated action and has transferred 400 million dollars into the Stock Fund to take care of future account increases due to the capitalization of Technical Stores.²

Technical Bureau Responsibility.--The protection of the Technical Bureau responsibility for control over the all important program and broad requirements determination function is of prime importance in any method used to handle Navy Stores. This is particularly important and is one of the practical aspects of Stock Funding, which means only a change in the method of financing. The organization mission or management and technical control function would not be changed

¹Public Law 216, Sec. 405, 81st Congress

²Executive Office of President, Bureau of the Budget, The Federal Budget Fiscal Year 1956 (Washington Government Printing Office, 1955)

in any way. The Technical Bureau would still maintain control over allowance lists, etc. In fact, these items would become more dynamic in that each Bureau and Fleet Commander would have an active interest not only in the items in the allowance, but in the cost of each allowance, in that it would be necessary to budget for each new outfitting and for replacement items. This would give the Fleet Commander and the Bureau an accurate cost of fleet maintenance. Items of local manufacture and local purchase would also be financed out of the Stock Fund if stocked for issue. Only items purchased or manufactured for immediate use, for which an obligation against an allotment is held, would be purchased or manufactured without Fund financing. The Bureau would have much better program control, in that its operation and maintenance budget and the Chief of Naval Operations program objective would be the same. Changes in program objective could immediately be reflected in maintenance and operation expenditures.

Appropriation Adjustments.--There are certain appropriation adjustments necessary to transfer funds from their present appropriations to the maintenance and operation appropriations in order that the Technical Bureau may have sufficient funds to procure materials from Stock account.

Presently, funds are included in both the Capital Equipment and the Maintenance and Operation Budgets of the various Bureaus for the procurement of spare parts. All funds previously requested in the Capital Budget would have to be eliminated, those in the Maintenance Budget reexamined and a new Maintenance Budget proposed for the material required, in order to support the Bureau program. The Stock financing portion would be completely eliminated. The unexpended balance of all existing contracts would be shifted on the selected cut-off day and all material delivered after that cut-off day would be paid for from the Fund. Legislation to transfer the unexpended balances to the Fund, as necessary, should be requested. This would add additional liquidity to the Fund.

Loss of Previously Paid for Material by Technical Bureau.--The loss to the Technical Bureau of material for which money would have to be reappropriated to it to buy back from the Stock Account after capitalization is very serious to these Bureaus. This, on the surface, would appear to work a hardship on the Technical Bureaus. Actually, while the money would have to be justified in the Maintenance Budget, Stock Funding would make the Budget more easily justified. The Maintenance Budget should then become less of a "whipping boy" when it can be directly related to the program objective. The net effect on the over-all Bureau Budgets should be to lessen them, as over 1 billion dollars per year has been used for additional stock financing.³ This would be eliminated under the Stock Fund. The proof of this is that Navy inventories have been building at the billion dollar rate for the last year or so. While this smaller amount will admittedly be in an area which is used as a "whipping boy" by Congress, by careful charting of the total Capital and Maintenance Budget under the Appropriation Purchases Account and Naval Stock Account systems of stores financing, the Technical Bureaus should be able to adequately justify any funds required. In effect, this loss of 4½ billion dollars in inventory will cause a lessening of annual appropriations so no damage will be caused if the money shifts are properly explained.

Repair of Damaged Material.--A method of control and financing the repair of used and damaged material is necessary. This presents a very difficult problem, although of no greater magnitude than under the present Appropriation Purchases Account financing. Any system must offer quick return and care of all parts desired for repair, and rapid disposal of those parts unrepairable or for

³Financial Report Fiscal Year 1954, Op. Cit., p. 70

which the system has sufficient stock. The best system would be for each Supply Demand Control Point to publish quarterly a list of those repairable parts desired retained. When material on this list was returned, the local supply officer carrying the unit's allotment would be instructed to credit the allotment of the activity turning in the damaged material, 10 percent (or some nominal percent) of the value to the unit's allotment.

This would offer the necessary incentive and allow sufficient mark up after repair to pay for the items reconditioned. All items, repaired or new, would be issued from the account at a standard unit price. This standard unit price would be published by the Supply Demand Control Point and revised from time to time as conditions warrant. The Supply Demand Control Point, as owner of the damaged material, would order the material automatically shipped to the designated Repair Facility and the local supply officer would have authority to obligate the Stock Fund as necessary to accomplish the repair to make the material ready for issue. He would show in a separate column in the Quarterly Stock Status Report receipts from damaged material. For accounting purposes an account, gain in value of material, due to repricing at the standard unit price after repair, would be maintained. This gain would be the standard unit price minus 10 percent payment to turn-in activity minus cost of repair. It can be seen that this method would eliminate many of the objectional features of the present system without causing any increase in work load.

Fleet and Station Allowances.--A method of financing material for Fleet and Station Allowances is necessary. Appropriation Purchases Account material to Ships and Stations has, because of the method of original financing, been free issue material. It has been loosely handled, drawn and turned in at will. Some of this freedom of action will be restricted by the use of the Stock

Account. All material issued will be to a final expenditure. Each time a part is drawn, an allotment will have to be charged. The system now used for Naval Stock Account material seems very applicable to technical material. Each activity will be given a working capital account by capitalizing its present inventory of material. Limits will then have to be established for each type ship and station. Each activity will then be given allotments with which they may purchase new material as material on hand is used. Material may be turned in for credit under the same rules now governing Naval Stock Account material. Generally speaking, these rules state that material must be in a ready for issue condition and there must be a requirement for it in the system. Each Quarterly Stock Status Report will have to be coded showing those items which will be accepted for credit. Items turned in for scrap will be given no credit and non-ready for issue items which are repairable will be credited at 10 percent of the value as any other damaged material. The money obtained from sale of scrap will generate to the fund as a gain. Another advantage of funding is that money obtained from sale of scrap or excess material is reusable and will not accrue to the credit of the Treasurer. Funds thus obtained can be used to help offset losses through obsolescence and other causes.

Obsolescence.--The financing of obsolescent material is a great problem, especially in aircraft and electronics materials. The rapid changes in design of both these items cause a large amount of materials to become obsolescent each year. This is one of the evils of progress and must be accepted as such. The system must be constantly purged of all material which is obsolescent, or funds tied up in these materials for which there is no market will quickly absorb the liquid assets which are required to procure new material to support new capital equipment. The only way to face this problem is when a capital item becomes

obsolete, to quickly separate the supporting stores and equipage and request yearly appropriations to offset the loss to the fund. This in all probability will be an item difficult to sell to the Bureau of the Budget and Congress, but as the light of day is shown brightly on these now covered up areas, procurement practices and inventory control technique will be developed to minimize its magnitude. Today we know material becomes obsolescent rapidly but because it is "free" material we are disinclined to view it with the seriousness it properly deserves. In this case, as Congress cracks the whip, necessity will become the mother of invention. New methods and procedures will be devised.

Material for Reserve Fleets Ships and Aircraft.--The control and financing of materials held for fleet vessels and aircraft is a big problem. The technical material held to support reserve aircraft and ships will tie up a great deal of the Stock Fund. However, the amounts capitalized are large enough at the present time to allow the stagnation of that portion of the Stock Account material required for this support. This is borne out by the fact that there were roughly 600 million dollars in issues from a $4\frac{1}{2}$ billion dollars worth of material. Broken down by material categories, these issues and inventories as of 30 September 1953 are as follows:⁴

<u>Symbol</u>	<u>Category</u>	<u>In Thousands of Dollars 12 Mo. Issue</u>	<u>In Thousands of Dollars Inventory</u>
Z	Ordnance Repair Parts	61,983	1,228,743
R	Aeronautical Material	360,640	1,978,883
H	Ships Repair Parts	71,669	556,179
A	Special Shipboard Elec. Fit. & Fix.	660	12,773
P	Submarine Repair Parts	6,231	51,783

⁴Navy Department, Bureau of Supplies and Accounts, Stock Finance Division Staff Study of Extension of Stock Fund Financing (mimeographed) 1954, p. 34

<u>Symbol</u>	<u>Category</u>	<u>In Thousands of Dollars 12 Mo. Issue</u>	<u>In Thousands of Dollars Inventory</u>
N	Electronic Repair Parts	45,132	219,084
Y	Vehicular Equip. Repair Parts	6,177	78,108
G	General Stores Material	26,981	184,499
U	Special Clothing	5,778	12,581

This illustrates that if present issue rates are maintained, the Navy has approximately an 8-year requirements in inventory. However, such an average is misleading. If aeronautical and electronic material were eliminated, the stock would be sufficient for 12 years and if ordnance alone was considered, the Navy would have a 20 year supply. Any such comparison as made herein is sheer fallacy and very dangerous. To say that inventory divided by issues gives years of supply is impractical except for illustrative purposes. At the same time you have over-all eight years' supply moneywise. Itemwise many and usually fast moving items are out of stock or in very short supply. These items and materials necessary for support of new capital equipment constantly require that funds be available for new procurement. The Navy in all probability could not operate effectively over 90 days without funds even though figures like the ones presented herein may appear to indicate otherwise. For this reason the inventories must be broken into two categories, with one considered as a current asset and the other as a term investment. The latter portion must not be compared against current issues. The inventories which are held for war reserve and for support of reserve aircraft and ships should be clearly shown and segregated. This can again be supported by the Chief of Naval Operations program objectives. If inventories are divided properly, no difficulty should be experienced in supporting appropriations when necessary to replenish the liquid

funds depleted by obsolescence or disposal of excesses. A vigorous program should be carried out to purge stock of all material over and above that required for:

1. Authorized current operating levels.
2. Authorized war reserves.
3. Authorized stocks to support reserve fleets and aircraft.
4. Authorized excess retained as contingent reserves.

Integration of Stock Reporting and Stock Financing.--The integration of stock reporting and financial control, in order that issues will reflect only final expenditures so that fund replacement and procurements will be in balance, is a vital necessity. This was largely accomplished by the solution to items 5, 6 and 7: a method of control and financing of the repair of used and damaged materials; a method of control and financing of materials for fleet and station allowance; and the financing of obsolescent material. This leaves shop stores as the only issues which are not immediately charged to a final expenditure. The Shop Store material must be carried on the books, both by item and money value, until issued. This will cause inventory control to carry shop stores on the cards and to charge issues twice, once when transferred to shop stores and again when issued to final expenditure. The transfer to Shop Store could be by additional card insertion. The Quarterly Stock Status Report will contain all material in both Supply and Shop Stores. This, with shop material and fleet ready issue stores being charged to a final expenditure when transferred, would make expenditures from the account balance procurements.

Spare Part Procurement.--The integration of spare parts procurement from Fund financing and Capital items procurement, so that advantage may be taken of capital item production equipment in production of spare parts, will require

very close liaison with the Technical Bureau. With the proper coordination this should be easily accomplished. The procurement of jet engine spare parts is currently handled in this manner. The Bureau of Aeronautics contracts for the engines. The Aviation Supply Office contracts for spare parts. There has been little difficulty in coordinating procurements of spares with production items. It would be equally simple to procure the same coordination between ordnance, electronics, ship and other contractors, as has been worked out with the aircraft engine manufacturers by establishing the proper relationship.

Department of Defense Regulations.--Modification of the Department of Defense regulations governing Stock Fund operations of 22 February 1954 applicable to Section 405 of the National Security Act of 1948 concerning Stock Funding is necessary. Section 405 of the National Security Act of 1948 provides the broad framework for working capital funds. It authorizes working capital funds for the purpose of "financing inventories of such stores, supplies, material and equipment as he may designate".⁵ This short statement is clear in its intent to permit working capital funds whenever they contribute to better management. To carry out this authority, the Secretary of Defense is "authorized to issue regulations to govern the operation of activities and the use of inventories". These regulations were issued on 2 February 1954. Seven limitations concerning the extension of Stock Fund financing are:⁶

1. "Cost of items of such categories when issued for use are chargeable to a number of activities, or the items of such categories are held primarily for sale to personnel of the department or personnel of other agencies."

Modification is necessary to allow a small number of local procurement standard items to be excepted from the general rule.

⁵Public Law 216, Sec. 405, 81st Congress

⁶Department of Defense Regulation Governing Stock Fund Financing dated 22 February 1954 (Duplicated) 1954

2. "In general there must be a recurring demand for the items of any category of material held by a Stock Fund so that the Stock Fund investment therein shall not become frozen."

Again, modification is necessary to allow stores to be fund financed if there is a potential possibility of issue. This would be necessary in order to fund finance war reserves and material held for reserve fleets and aircraft.

3. "Generally, the items included in Stock Funds shall be confined to those held for issue and for supply purposes and not extended to include those held for capital investment or for use. In this connection, the following types of items shall be excluded:

(a) Real Estate, installed equipment, industrial and similar machinery and equipment issued and in use or held in store for future use.

(b) Aircraft, ships, tanks, military type vehicles, artillery and similar items. Although it is difficult to draw a specific line, this paragraph shall not be construed to prevent including in Stock Funds relatively minor items of equipment or components of the foregoing items, if there is a recurring demand for them, so long as they are held in store and are not in use."

There are no changes required in this section but since other amendments must be proposed, it would be expedient to substitute "expected demand" for "recurring demand".

4. "Notwithstanding the general rule that determination of items of materials to be included in Stock Funds shall be made by category, any individual item shall be excluded from a Stock Fund if it is not fully developed for use or application and there is a major contingency that will not be stocked for continued recurring use."

This section appears sound, as it apparently refers to research and development items.

5. "Normally, the criteria stated herein for the selection of items to be properly included under a Stock Fund would result in the exclusion of most items having high potential obsolescence. However, that factor alone is not controlling in the selection of categories or items to be included in the Stock Fund."

This section should be amended. Technical items, by their nature, have a high obsolescence. This section would not eliminate Fund financing for these items, but it should be made more permissive.

6. "Normally, standardized specifications for items included in a Stock Fund should be available. Non-standard items may be included only pending standardization or when stocked as substitutes for standard items. Each military development shall require the forced usage of non-standard items when necessary to prevent losses or frozen inventories in the Stock Fund."

Current planning within the present Navy Stock Fund envisions extension to non-standard area under commercial type open-to-buy technique and policed dollar/inventory limitation. Experiments to date have proved this type material beneficial, even though non-standard. A substitute provision should permit financing of legitimately required non-standard items when controlled by commercial open-to-buy techniques and policed dollar/inventory limitations.

7. "The Stock Fund shall not be used for financing the purchase of and investments in stocks for resale to personnel of the Armed Service primarily for their personal convenience, with a mark-up over cost to cover expenses or welfare contributions. Pending determination of policy relative to the permanent method of financing certain resale activities heretofore financed under the Navy Stock Fund, such stock may be included in the Navy Stock Fund."

While this has no effect on technical stores, the funding of all stores under one Fund would be more flexible; therefore, considering the successful experience of the Navy with the financing of Ship Stores under the Stock Fund, this provision should be eliminated.

The presentation to the Department of Defense of a properly documented case should secure the desired changes with a minimum of difficulty.

The solution of these problems are administrative in nature. All except the Department of Defense regulation concerning Stock Funding are within the power of the Secretary of the Navy to change. Therefore, there is no basic law which would be required. The implementation, therefore, is clearly a matter almost completely within the Navy and requiring concurrence of only the Department of Defense.

CHAPTER VI

ORGANIZATION FOR ADMINISTRATION OF CAPITALIZED TECHNICAL STORES INTO NAVAL STOCK ACCOUNT

Increase in Responsibility of Stock Fund Administrator.--The concept as presented herein does not change any mission of any Navy organization, but it does vastly increase the responsibility of the Administrator of the Naval Stock Fund. The Chief of the Bureau of Supplies and Accounts is designated as the Fund Administrator, but he must have assistants to administer this and various other programs for which he is responsible.

Business Financial Organization Concept.--Business has found it necessary to have a Financial Vice President to manage the financial assets of a business much simpler and much smaller. The Stock Account and Fund, after the Capitalization of Technical Stores, will total about 7.1 billion dollars. The best financial organization today calls for a Financial Vice President with a Comptroller and a Treasurer reporting to him. The Bureau of Supplies and Accounts' internal organization could be improved from a study of organization of some of the larger businesses. The concept presented herein has been developed as a composite of the best features presented by Comptrollers and Financial Vice Presidents of over 26 of the largest corporations in the United States.

Proposed Organization for Bureau Supplies and Accounts Financial Management.--The organization proposed is shown in Figure 1, and is a result of a study of organization of the companies listed below:

Bush Electronics Co.
General Foods
Allegheny Ludlum
Atlantic Refining Co.
IBM
Cerro de Pasco Ent.
Lincoln Electric
Nanatuck Chemical
C & O Railroad
Standard Oil of Ohio
Maxwell House Coffee
A-C Sparkplug
Owen-Illinois Glass

Southern Pacific Railroad
Consolidated Edison Co.
Sperry Gyroscope Co.
General Motors
DRAVO
Proctor & Gamble
Armstrong Cork Co.
Western Union
Corn Products
U. S. Steel
Pittsburgh Plate Glass
Hershey Corp.
Socony Vacuum Co.

This organization would transfer all financial management and accounting to the Assistant Chief for Financial Affairs. Under this Assistant Chief there would be two Divisions, the Comptroller and the Stock Fund Manager. The Comptroller would be composed of four branches, one for stock accounting, one for capital cost accounting service to other Bureaus, one for work measurement and one for budget and analysis reports.

The functions of the Bureau of Supplies and Accounts have been aligned into four operational assistants, Supply Management, Disbursing, Purchasing and Transportation, with a coordinating staff consisting of the Assistant Chief for Financial Affairs and other presently constituted staff officers. The line accounting is included in the Coordinating Staff, but it is a common business practice for the field Comptroller to wear two hats, a functional one to the Staff Comptroller and a line one to the Division Manager, and for the Headquarters Comptroller to have centralized line accounting in addition to his staff function. In all cases reviewed, the Comptroller was the Chief Accounting Officer of the corporation. This procedure is recommended so that the Financial Assistant Chief may have control over chart of accounts, and reports issued from these accounts, in order to make the dynamic reports needed by top Navy management to control the Navy.

Value of Assistant Chief for Financial Management.--The creating of the Assistant Chief for Financial Management would give the Chief of the Bureau of Supplies and Accounts a Senior Staff Officer to advise on financial management. The financial management organization is the only place where all programs come together. By placing the Stock Fund Administrator and the Comptroller under an Assistant Chief for Financial Management a Senior Staff Officer independent of operating influences would have the entire financial picture of the Bureau under constant study. He will have a chance to review all programs. He will be able to advise the Bureau Chief of Program in-balance or blind spots in proposals. Such in-balance or blind spots can many times be seen by staff appraisal of the total picture which is not apparent to operating personnel charged with only a portion of the program. This in no way would imply that the Assistant Chief for Financial Management would take action to solve such problems but merely to point them out so operating personnel could resolve them. Financial Management is a Staff function and must always remain so if it is to perform its proper function for top management.

DEPARTMENT OF THE NAVY
BUREAU OF SUPPLIES AND ACCOUNTS

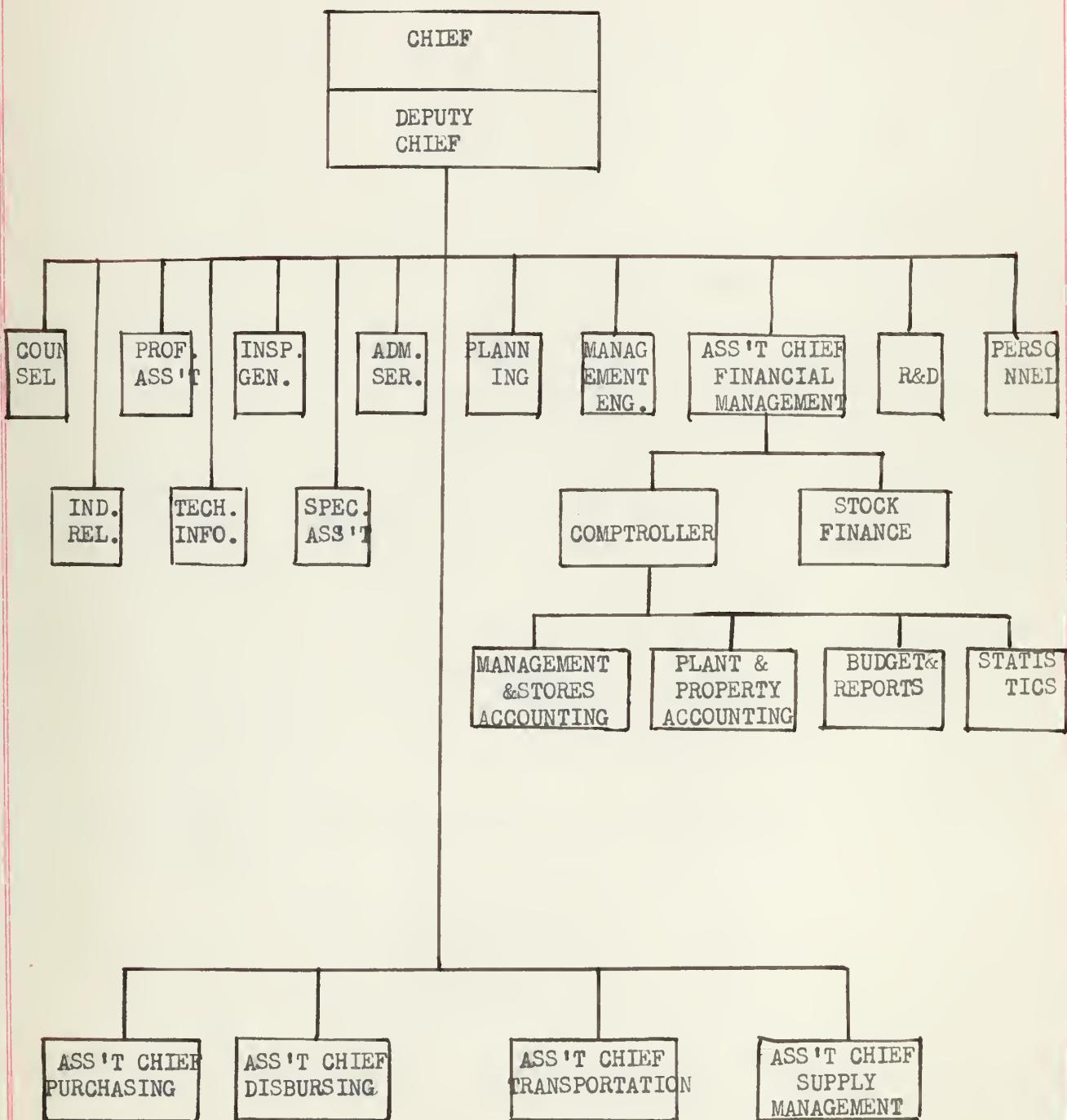


Figure 1

CHAPTER VII

GAINS TO THE NAVY FROM THE CAPITALIZATION OF TECHNICAL STORES INTO THE NAVY STOCK ACCOUNT

Recommendation to Capitalize.--It is recommended that the Navy take immediate steps to implement the capitalization into the Stock Account of all Technical Stores.

Advantages.--The following summation of advantages would occur from capitalization of Technical Stores.¹

1. Extension of the Stock Fund would substantially aid top Navy Management in reviewing, evaluating, and balancing stock investment position and plans of all Bureaus and agencies, for peacetime programs and mobilization readiness.
2. Extension of the Stock Fund would be a logical parallel to recent integration of supply management and effect common placement of responsibility and authority in these two inter-related areas.
3. A clear separation between stock investment and consumption programming and funding would result with substantial benefits to all Bureaus.
4. Heightened cost consciousness, as a part of the actual charge requirement on end issues, will reduce supply costs and sharpen control data.
5. Supply management data would be simplified and improved by the elimination of the several stores accounts now in use for holding inventories of supply items.
6. The present compartmentation by fiscal years and the direct relationship of purchase to availability or non-availability of annual appropriations would be removed. Purchases would be related solely to predicted need and management data could be reviewed on a continuing basis, with recognized flow between fiscal years.
7. Budgeting would be simplified and markedly improved by consolidation of all stock investment programs in an integrated Stock Fund Budget.

¹Department of Navy, Bureau of Supplies and Accounts, Staff Study of Extension of Stock Fund Financing (mimeographed) 1954

8. Stock items for supply purposes would in all instances, be held for the Navy as a whole, for use as dictated by priorities of the Navy's total program.

The above summary of advantages states in detail the points to be gained from capitalization. However, for emphasis, one is restated. Capitalization of Technical Stores into the Naval Stock Account will give better control and utilization of available funds.

Gains to Navy from Capitalization.--Today it is entirely conceivable that improper presentation or misunderstanding can jeopardize Navy supply support by causing an irrational or misunderstood cut in the funds granted to an appropriation. For example, under the present appropriation purchases account system it is entirely conceivable that Congress might look at the inventory available to any one Bureau, compare it with issues and appropriate no money for a program. Under Capitalization of Technical Stores into the Stock Account this is no longer a problem. The Stock Fund will enable the Chief of Naval Operations to review what is available and to set levels which will best meet his program objectives for peacetime operation and mobilization plans. Navy capitalization will allow a much better balance than has been obtainable heretofore. Under Capitalization the matching of Budgets and Navy program objectives will become a practical reality.

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